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IN THE

Supreme Court of the United States

OCTOBER TERM, 1932.

No. 842.

GALEN L. TAIT, COLLECTOR OF INTERNAL REVENUE,
PETITIONER,

versus

WESTERN MARYLAND RAILWAY COMPANY,
RESPONDENT.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

EUGENE S. WILLIAMS,
WILLIAM C. PURNELL,
Attorneys for Respondent.

The Daily Record Co. Print, Baltimore.

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BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

Respondent prays that certiorari be denied in the above entitled cause for reasons hereinafter presented.

OPINIONS BELOW

The opinion of the United States District Court for the District of Maryland (R. 38) is reported in 53 Fed. (2d) 211, and the affirming opinion of the Circuit Court of Appeals for the Fourth Circuit (R. 52) is reported in 62 Fed. (2d) 933. The opinion of the latter court in the previous case, by reason of which respondent contends the present case is *res judicata*, is reported in 33 Fed. (2d) 265.

QUESTIONS TO BE DETERMINED.

1. Whether the circumstances here presented are such as to necessitate or justify further pronouncement by this Court of the applicability of the principle of *res judicata* in tax litigation.

2. Whether, if the present case is not controlled by the principle of *res judicata*, respondent is entitled, in computing its taxable income for the years 1920 to 1925, to deduct the amortized discount at which certain bonds, the payment of which it has assumed, were sold by its predecessor company.

SUMMARY OF ARGUMENT.

I. There is no reason or authority for denying effect to the principle of *res judicata* in tax litigation.

(a) That the rule is applicable to tax cases, if the matter in issue or point of controversy is the same, though involving taxes for years subsequent to the one adjudicated, has been settled by this Court. Here the question is the same as that previously determined, to wit, the effect of the reorganization of respondent's predecessors upon its claim to the deduction.

(b) The distinction between the instant case and *United States v. Stone & Downer Co.*, 274 U. S. 225, is that which was drawn by this Court in distinguishing *New Orleans v. Citizens Bank of Louisiana*, 167 U. S. 371.

(c) The suggested difference between the evidence in this and the former case is immaterial, because the matter in issue remains unchanged.

That the parties are identical has been determined by this Court.

(d) *Res judicata* is not to be denied application in tax cases merely because the successful litigant may alone benefit. The contrary conclusion would defeat the principle in most, if not all, instances. Nor is the principle affected by petitioner's reasoning that if the decision in the former case in respondent's favor is to permanently stand discrimination would result against a taxpayer claiming a similar right, if his claim is denied by the courts. If this be true, the situation was created by the government when it decided not to seek review by this Court of the former case. Petitioner cannot reasonably expect to determine the rights of all taxpayers in a single suit in which only one may be a party.

II. The present controversy is *res judicata* and not open to review on the merits. This is true, even if the prior adjudication was based upon an error of law or fact. Viewed on the merits, however, respondent is entitled to the deduction, for, having assumed the payment of the bonds, respondent stands in the place of its predecessors with respect to such bonds and has the same right to deduct the amortized discount.

ARGUMENT.

I.

THERE IS NO REASON OR AUTHORITY FOR DENYING EFFECT TO THE PRINCIPLE OF RES JUDICATA IN TAX LITIGATION.

Petitioner's contentions are below answered in the order in which they are presented.

(a) Petitioner contends that because the revenue acts give a separate right of action to collect each year's taxes, the principle of *res judicata* cannot be applied to defeat full determination of the amount of taxes due each

year. The substance of the contention is that the government has a fresh start each year.

This Court has expressly held *res judicata* applicable in tax litigation where the demand in suit arose upon an assessment for a subsequent year. In the leading case of *New Orleans v. Citizens Bank of Louisiana*, 167 U. S. 371, this Court, in deciding that the statutory exemption of a bank's capital and stock determined for one year was *res judicata* on the question of the exemption of the same capital and stock in a subsequent year, said:

> "The proposition that because a suit for a tax of one year is a different demand from the suit for a tax for another, therefore *res judicata* cannot apply, whilst admitting in form the principle of the things adjudged, in reality substantially denies and destroys it. The estoppel resulting from the thing adjudged does not depend upon whether there is the same demand in both cases, but exists, even although there be different demands, when the question upon which the recovery of the second demand depends has under identical circumstances and conditions been previously concluded by a judgment between the parties or their privies. * * *
>
> "It follows then, that the mere fact that the demand in this case is for a tax for one year, and the demands in the adjudged cases were for taxes for other years, does not prevent the operation of the thing adjudged, if in the prior cases the question of exemption was necessarily presented and determined upon identically the same facts upon which the right of exemption is now claimed." (P. 396, 398).

Accord: *Gunter v. Atlantic Coast Line R. Co.*, 200 U. S. 273; cf. *Baldwin v. Maryland*, 179 U. S. 220; *Bank of Kentucky v. Stone*, 174 U. S. 799, affirming without opinion,

Judge Taft in *Bank of Kentucky v. Stone*, 88 Fed. 383. And see *Hoystead v. Commissioner of Taxation*, (1926) A. C. 155, where the application of *res judicata* by the House of Lords is precisely that now contended for by respondent.

The general rule as stated in *Southern Pacific R. R. Co. v. United States*, 168 U. S. 1, also banishes the theory advanced by petitioner that the question is preserved for subsequent litigation between the parties because the income tax laws create a different cause of action for each succeeding year:

> "The general principle announced in numerous cases is that a right, question, or fact distinctly put in issue and directly determined by a court of competent jurisdiction, as a ground of recovery, cannot be disputed in a subsequent suit between the same parties or their privies; *and even if the second suit is for a different cause of action, the right, question, or fact once so determined must, as between the same parties or their privies, be taken as conclusively established, so long as the judgment in the first suit remains unmodified.*" (Italics supplied.) (P. 49).

Accord: *United States v. California Bridge & Construction Co.*, 245 U. S. 337; *Cromwell v. Sac County*, 94 U. S. 351.

The question now in issue is the effect of the reorganization of respondent's predecessors upon the right of respondent to deduct the amortized items of discount involved in the sale of such bonds. It is precisely this question which was specifically in issue on the previous appeal, and which was determined in favor of respondent. (*Western Maryland Railway Co. v. Commissioner*, 33 Fed. (2d) 695, 696). That decision was not further ap-

pealed by the Commissioner to this Court, as he had a right to do if he deemed it erroneous. The authorities cited above amply sustain respondent's right to invoke *res judicata* to protect the rights it secured by that judgment.

There is nothing in *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, to the contrary. It was simply pointed out in that case, as we understand it, that fixed periods of accounting for income are applicable under the revenue acts, and that making these periods of annual duration was not an arbitrary provision.

United States v. Ness, 245 U. S. 319, *Maney v. United States*, 278 U. S. 17, and *Tutun v. United States*, 270 U. S. 568, establish no general principle, as contended for by petitioner, limiting the application of *res judicata* where statutes provide cumulative remedies. They determine merely the narrow point of the effect of Sections 11 and 15 of the Naturalization Act of June 29, 1906.

(b) There is clearly no conflict with *United States v. Stone & Downer Co.*, 274 U. S. 225, because that case deals with the peculiar considerations applicable to the Court of Customs Appeals, and as is pointed out in the opinion, "These are the reasons, too, why the principle laid down by this court in the decision already referred to, in *New Orleans v. Citizens Bank*, 167 U. S. 371, should not apply or control." (P. 237).

(c) The existence of differences of fact between this case and the prior one, as suggested by petitioner, is of no moment in determining the applicability of *res judicata*. The nature of the "matters in issue or points controverted" (*Cromwell v. Sac County*, 94 U. S. 351, 353), is not changed in any particular, since, as pointed out below,

this evidence merely "shows more clearly the gap between the present corporation and the one which issued the bonds" (R. 55). The question for decision which has been heretofore stated remains thus unchanged by the enlargement of the facts which underlie it. The language in *Baltimore Steamship Co. v. Phillips*, 274 U. S. 316, 321, accurately describes the present situation:

> "*A cause of action does not consist of facts, but of the unlawful violation of a right which the facts show.* The number and variety of the facts alleged do not establish more than one cause of action so long as their result, whether they be considered severally or in combination, is the violation of but one right by a single legal wrong. The mere multiplication of grounds of negligence alleged as causing the same injury does not result in multiplying the causes of action. 'The facts are merely the means, and not the end. They do not constitute the cause of action, but they show its existence by making the wrong appear. 'The *thing*, therefore, which in contemplation of law as its *cause*, becomes a ground for action, is not the group of *facts* alleged in the declaration, bill, or indictment, *but the result of these in a legal wrong, the existence of which, if true, they conclusively evince.*'" Chobanian v. Washburn Wire Co., 33 R. I. 289, 302, 80 Atl. 394, Ann. Cas. 1913D, 730." (Italics in first sentence ours.)

Cf. *Grubb v. Public Utilities Commission*, 281 U. S. 470, 479; *Hoystead v. Commissioner of Taxation, supra.*

Petitioner suggests that the parties in two of the present cases (Law Nos. 4172 and 4469, R. 1) and the former case are not identical. This is based upon the ground that in these suits the Collector is made the defendant, while in the former appeal the proceedings were against the Commissioner. Any doubt of the sufficiency of iden-

tity of the parties, in so far as the present discussion is concerned, seems dispelled by *Old Colony Trust Company v. Commissioner*, 279 U. S. 716, where this Court, in dealing with the difficulty that under Sections 283(b) and 284(d) of the Revenue Act of 1926, suits in court could still be brought in cases instituted before the Board prior to the 1926 Act, while the latter act at the same time made proceedings from the Board exclusive, said:

> "But the apparent conflict in such cases can be easily resolved by the use of the principles of res judicata. If both remedies are pursued, the one in a district court for refund, and the other on a petition for review in the circuit court of appeals, the judgment which is first rendered will then put an end to the questions involved and in effect make all proceedings in the other court of no avail. Whichever judgment is first in time is necessarily final to the extent to which it becomes a judgment." (P. 728).

While the Collector or the United States is necessarily the defendant in a proceeding in the district court to recover taxes, and the Commissioner is necessarily the defendant in cases appealed from the Board of Tax Appeals, this Court seems clearly to have regarded such defendants as identical. The reasons stated for the like conclusions reached in the lower courts, in the cases cited by petitioner, are clearly sound.*

(d) Petitioner's assertion of the necessity for an unfettered application of tax decisions in the administration of tax laws is, of course, a demand for a complete denial of *res judicata* in income tax cases. It is the claim of a right to force respondent to litigate its tax liability

* The Collector is subjected to suits for refund simply because of his official agency for the United States, so that while a judgment against him individually as agent may well not bind the principal, the converse is by no means true. See *Second National Bank of Saginaw v. Woodworth*, (D. C. Mich. 1931) 54 Fed. (2d) 672.

on these bonds for each year until their maturity in 1952. That the possibility of repeated litigation exists is apparent from the record in this case.

Respondent obtains through *res judicata* no unfair advantage such as petitioner appears to imply. It secures only the results of thorough litigation. If the government was of the opinion that the former decision was erroneous it could have sought review by this Court. So in *Reed v. Allen*, 286 U. S. 191, the failure to appeal from a judgment founded on a prior judgment subsequently reversed, was held not to justify a denial of the application of *res judicata* to the second judgment, simply because of the hardship involved. In the course of that opinion it is said:

> "The predicament in which respondent finds himself is of his own making, the result of an utter failure to follow the course which the decision of this court in Butler v. Eaton, supra, had plainly pointed out. Having so failed, we cannot be expected, for his sole relief, to upset the general and well established doctrine of *res judicata*, conceived in the light of the maxim that the interest of the state requires that there be an end to litigation—a maxim which comports with common sense as well as public policy. And the mischief which would follow the establishment of a precedent for so disregarding this salutary doctrine against prolonging strife would be greater than the benefit which would result from relieving some case of individual hardship." (P. 198-199).

There is no valid reason why these considerations are not equally applicable to the government in the assertion of tax demands. Taxpayers are unquestionably entitled to rely upon the sanctity of tax judgments, to no less extent than those recovered in any other civil proceeding. Concededly the government

is not to be unduly hampered in administering the revenue laws, but the government is not immune to most of the well established rules of law, including *res judicata*. Respondent would certainly be bound by the former decision if it had been adverse, and the equal administration of the revenue laws does not require that the government be differently treated, even if that could be done legally. The common principle that the taxpayer is entitled to the benefit of any doubts arising in the construction of tax laws is wholly inconsistent with petitioner's proposal which would deny the benefit of a construction secured.

Nor does any good reason appear why the government should be permitted to litigate a question in a single case such as *Handy & Harman v. Burnet*, 284 U. S. 136, referred to by petitioner, and yet expect its conclusions to apply against other taxpayers who have raised the same question in other suits, but whose cases have been allowed to terminate adversely to the government. It is obviously not necessary to bring to this Court every case which involves the same point of law, though there are numerous instances where the government has deemed a point to be of sufficient importance to carry several cases involving such point to this Court for decision at the same time or in the same term.* Nor, on the other hand, is the government at liberty to forego its rights as to one taxpayer on the theory that the determination of another's rights will necessarily settle those of the former as well.

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* See for example the cases decided at the last term involving the validity of Section 302(c) of the Revenue Act of 1926. *Heiner v. Donnan*, decided March 21, 1932, 285 U. S. 312; *Handy v. Delaware Trust Co.*, March 21, 1932, 285 U. S. 352; *Anderson v. Guinzburg*, certiorari denied March 28, 1932, 285 U. S. 553; *White v. Hall*, certiorari denied March 28, 1932, 285 U. S. 553.

To petitioner's assertion that the importance of *res judicata* in tax cases is such as to require a review in the present instance it may be said that this general question has been repeatedly treated by this Court and may be now regarded as settled. *New Orleans v. Citizens Bank*, supra; *United States v. Stone & Downer*, supra; *Old Colony Trust Company v. Commissioner*, supra.

II.

THE MERITS OF THE PRESENT CASE ARE NOT OPEN TO REVIEW.

Respondent denies that the right to deduct amortized bond discount is lost by a change in identity of the corporation issuing the bonds. The right to deduct the discount arises from the fact that respondent took over the property of its predecessor and assumed payment of the bonds. Respondent, therefore, stands in place of the issuing company, with respect to the bonds and the discount, and is equally entitled to the deduction.

In any event, the question is not open to review. "But a *fact, question,* or right distinctly adjudged in the original action cannot be disputed in a subsequent action, even though the determination was reached upon an erroneous view or by an erroneous application of the law." *United States v. Moser*, 266 U. S. 236, 242. *American Express Co. v. Mullins*, 212 U. S. 311; *Reed v. Allen, supra; Vinson v. Graham*, 44 Fed. (2d) 772.

Respectfully submitted,

EUGENE S. WILLIAMS,
WILLIAM C. PURNELL,
Attorneys for Respondent.

RESPONDENT'S BRIEF

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Respondent.

BRIEF FOR THE RESPONDENT.

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WILLIAM C. PURNELL,
Attorneys for Respondent.

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OPINIONS BELOW.

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STATEMENT.

The essential facts are sufficiently set forth in the brief for the petitioner.

QUESTIONS PRESENTED.

1. Is not the decision of the Circuit Court of Appeals for the Fourth Circuit in *Western Maryland Railway Company v. Commissioner res judicata* of the present controversy?

2. Is not the respondent entitled, in any event, in computing its taxable income for the years 1920 to 1925, to deduct from gross income the annual proportion of the discount at which certain bonds were sold by its predecessor companies, the payment of which it has assumed?

3. If the respondent is not entitled to deduct the discount arising from the sale of a portion of the bonds prior to the 1910 reorganization, is it not entitled to deduct the discount arising from the sale of the remaining portion of the bonds after that reorganization?

SUMMARY OF ARGUMENT.

I.

The issue in this case has already been adjudicated in *Western Maryland Railway Company v. Commissioner*, 33 Fed. (2d) 695. The principle of *res judicata* is, therefore, applicable. The contention of the petitioner that the revenue acts preclude the application of that principle in income tax cases, or that public policy so requires, is untenable.

It was determined in the former case that the respondent, in computing its annual income tax liability, has the right to deduct the amortized discount at which certain bonds were sold by its predecessor companies. The fact that different tax years are now involved is of no consequence, the question of the respondent's right to amortize the discount over the life of the bonds, for income tax purposes, remaining the same.

This Court has repeatedly held that the principle of *res judicata* is applicable in tax litigation. The reason for the principle applies equally here.

Neither the language of the revenue acts nor the reason for allowing deductions for discount supports the petitioner's contention that the revenue acts contemplate that the principle be not applied in income tax cases. Nor is the contention valid that public policy demands that the principle be not applied in this character of litigation.

II.

There is no such difference of parties as renders inapplicable the principle of *res judicata.*

The decisions that a judgment against a collector, being personal in its nature, does not bind the Government are not authority against the proposition that a prior judgment adverse to the Government may not bind a collector. Different considerations apply in the latter instance and the reasons for the application of the rule exist.

III.

The revenue acts and the regulations entitle the respondent to the deductions, although the bonds were issued by its predecessors.

Admittedly, the respondent's predecessors would have been entitled to the deduction if there had been no corporate change. The reason for allowing the deduction is that the discount represents, in part, the cost of the borrowed money. The respondent, having succeeded to the property and assumed the payment of the bonds and interest, occupies the same position with respect to the

discount, the bonds and the property as did the issuing company, and is equally entitled to amortize the discount.

IV.

Whether or not the respondent is entitled to deduct for the discount arising from the sale of a portion of the bonds prior to the 1910 reorganization, it is entitled to deduct for the discount at which the remaining bonds were sold after that reorganization by The Western Maryland Railway Company, because that company and the respondent are, to all intents and purposes, one and the same. This is true because the consolidation merely changed the corporate form of the respondent's existence.

ARGUMENT.

I.

THE ISSUE IN THIS CASE WAS CONCLUSIVELY SETTLED BY THE FORMER DECISION. PETITIONER'S CONTENTION THAT THE REVENUE ACTS PRECLUDE THE APPLICATION OF THE PRINCIPLE OF RES JUDICATA, AND THAT PUBLIC POLICY REQUIRES THAT THE PRINCIPLE BE NOT APPLIED IN INCOME TAX CASES, IS UNTENABLE.

The question decided by the Circuit Court of Appeals in the former case was whether the respondent, in computing its annual income tax liability, has the right to deduct the amortized discount at which certain bonds were sold by its predecessor companies. It is that question which the Government again raises. The years are different, but the issue is the same, as the opinion of the court below clearly shows. This is also shown by the record and pleadings in the former case (Exhibit D, p. 25, par. (5)), and the following from the Government's brief in the present case (p. 10):

> "The sole question is whether the determination of the issue of the respondent's right to deduct amortized discount on the bonds sold by its predecessors in the earlier decision necessarily constitutes an estoppel by judgment which precludes a reconsideration of the question in this case."

It may be said at the outset that the decisions of this Court have settled that the principle of *res judicata* is applicable in tax litigation. *City of New Orleans v. Citizens Bank of Louisiana*, 167 U. S. 371; *Stone v. Deposit Bank*, 174 U. S. 800; *Deposit Bank v. Frankfort*, 191 U. S. 499; *Baldwin v. Maryland*, 179 U. S. 220; *Gunter v. Atlantic Coast Line Ry. Co.*, 200 U. S. 273. The principle was also expressly recognized in *United States v. Stone & Downer Co.*, 274 U. S. 225, and *Old Colony Trust Company v. Commissioner*, 279 U. S. 716, 728. The House of Lords has applied the principle in tax litigation. *Hoystead v. Commissioner of Taxation*, 1926 A. C. 155. In the first group of cases cited and in *Hoystead v. Commissioner of Taxation*, the fact that the subsequent proceeding involved taxes for a later year or years than were involved in the prior adjudication did not prevent the application of the principle. It was said in *City of New Orleans v. Citizens Bank of Louisiana* (pp. 396, 398):

> "The estoppel resulting from the thing adjudged does not depend upon whether there is the same demand in both cases, but exists, even although there be different demands, when the question upon which the recovery of the second demand depends has under identical circumstances and conditions been previously concluded by a judgment between the parties or their privies. * * *
>
> "It follows, then, that the mere fact that the demand in this case is for a tax for one year, and the demand in the adjudged cases were for taxes for other years, does not prevent the operation of the

> thing adjudged, if in the prior cases the question of exemption was necessarily presented and determined upon identically the same facts upon which the right of exemption is now claimed."

It is true that in no case has this Court dealt specifically with the applicability of the principle of estoppel by judgment in litigation arising under the federal income tax laws. The fundamental reason for the principle is apparent. But for the rule "nothing would be settled, and the judgment, unreversed, instead of having the effect of forever settling the rights of the parties, would be but an idle ceremony." *Deposit Bank v. Frankfort, supra,* (p. 511). The doctrine is as applicable to controversies between the Government and an individual as to other controversies. *United States v. Moser,* 266 U. S. 236; *Southern Pacific Ry. Co. v. United States,* 168 U. S. 1, 49.

It is the Government's contention, however, that the revenue acts disclose an intention, and the public policy demands, that the principle shall not apply in income tax litigation.

It may be noted in passing that the Government has previously litigated in this Court an income tax case involving the principle of estoppel by judgment without suggesting, in so far as the opinion discloses, that any reasons of public policy demand that the principle be not applied in such cases, but tried the case upon the narrow question of whether there was identity of parties. *Bankers Pocahontas Coal Co. v. Commissioner,* No. 104, October Term, 1932. Indeed, in cases before the Board of Tax Appeals the Government has, on more than one occasion, successfully contended for the application of *res judicata* in just such instances as is

now urged there is a public interest which forbids its application. *Appeal of Gilliam,* 2 B. T. A. 272; *Appeal of Mary Haller,* 26 B. T. A. 395. While it is stated in the Government's brief (foot-note, p. 17) that the Government is not arguing for the application of the doctrine in its brief in the latter case now on appeal in the District of Columbia, the fact that the Government has argued for the application of the principle on various occasions would seem to indicate, at least, that it has not heretofore regarded that the public interest was being jeopardized.

There is next considered the two propositions advanced by the Government, first, that the revenue acts have by implication abolished the principle of *res judicata,* and, second, that public policy requires that the principle be not applied in federal income tax cases. We contend that neither of these propositions is tenable.

THE REVENUE ACTS HAVE NOT ABOLISHED THE PRINCIPLE OF RES JUDICATA.

The revenue acts involved nowhere expressly declare any intention to repudiate the general principle of estoppel by judgment. Recognizing this fact, the petitioner asks the Court to read such an intention into those acts. Certain unrelated provisions of the acts are relied upon in justification. First it is pointed out that the liability under the revenue acts is an annually recurring one which is enforceable in separate successive proceedings. But the same may be said of taxes generally. The fact was regarded as immaterial by this Court in *City of New Orleans v. Citizens Bank of Louisiana, supra,* and other cases cited above.

The provision of the statute is cited that where a court decision changes a Treasury regulation such decision is to be given retroactive effect. The apparent purpose of

that provision is to require that if the regulation has been incorrectly applied in previous unlitigated cases the mistake shall be corrected. If this provision affords any indication of the statutory intent it is that Congress did not intend to veto, but rather to give full recognition to, court adjudication.

The provision of the statute authorizing closing agreements between taxpayers and the Government for particular years is cited, together with a decision of the Board of Tax Appeals in effect that facts set forth in such agreements can be contradicted subsequently in disputes involving other years. The suggestion seems to be that, as the statute provides in such a situation that there shall be no *estoppel by agreement*, it must also have intended that there be no *estoppel by judgment*. It would have been equally simple to provide that there shall be no estoppel by judgment if Congress had so intended. Again, it is clear that the reasons for applying the principle in the case of a prior judgment have no application to a voluntary agreement between parties which they themselves intended should apply to one year only.

Lastly, it is cited in this connection that the statute gives the Board of Tax Appeals the power to inquire into facts relating to preceding years, in order to determine the correct liability for a subsequent year. The purpose of this provision, it would seem, is simply to enable the Board to effectively accomplish its object of ascertaining the correct liability for the year involved. This, in some instances, would necessitate inquiry into preceding years in order that the Board may have before it all relevant facts in determining the true tax liability.

THERE IS NO POLICY REQUIRING REPUDIATION OF THE PRINCIPLE OF ESTOPPEL BY JUDGMENT IN FEDERAL INCOME TAX CASES.

It is next argued by the Government that, as each year creates a new tax obligation, "serious consequences would result" if the rule of estoppel by judgment is applied to income tax cases relating to years not involved in the prior adjudication; that discrimination may result between taxpayers, and that a sound policy, therefore, requires that the principle be repudiated in this character of litigation. Reliance is principally placed upon *United States v. Stone & Downer Co., supra.* The decision related to the binding effect of a prior classification of imports by the court of customs appeals and was expressly intended not as a precedent in tax litigation. Early in the opinion it is stated (p. 230):

> "It is settled in this court that the general rule by which a judgment estops the parties in future litigation between them, to question either a fact or a point of law necessary to the first judgment and adjudicated therein, applies to cases of taxation as well as to other subjects of litigation."

The Court then pointed out that there is a clear distinction between an official classification of imports for duty and a court adjudication in tax cases; that the court of customs appeals made its own rules and must necessarily determine, as a practical matter, what should be the conclusive effect of its own judgment in subsequent proceedings involving the various classifications by it, and that from the beginning that court had declined to be bound by its previous decisions. This Court held that it would not, in view of the peculiar problems inherent in the classification of imports, interfere with the sound policy adopted by the court of customs appeals in not being bound by its previous decisions. The case can in no sense, therefore, be said to furnish a precedent, as suggested by

petitioner, for overthrowing the principle in income tax cases.

A number of cases are cited by the petitioner to support its contention that discrimination will result. They hardly serve the purpose. *Handy & Harman v. Burnet*, 284 U. S. 136, is cited to show that discrimination will result if the decision of this Court is not to apply equally to all similarly situated, including any who may have obtained prior judgments contrary to the decision of this Court. The argument is purely conjectural and does not undertake to cite any instance where a taxpayer procured a prior favorable decision in a lower court and, as a result, may enjoy benefits from filing consolidated returns under conditions falling short of the statutory requirements, as construed by this Court in the case cited.

The petitioner also cites *Burnet v. Jergins Trust*, No. 541, October Term, 1932, where this Court held that a lessee of certain municipal property was not immune from the federal tax upon the profits derived from the leased premises. The court below had decided the contrary. It is argued that the taxpayer would have perpetually enjoyed the benefits of the lower court's decision if the decision had not been appealed from, and the correct rule had not been laid down by this Court until a later case. Here, as in *Handy & Harman v. Burnet, supra*, the Government relies on pure conjecture. Speculation is indulged in as to what might have happened if the Government had fallen short of its duty to have a timely adjudication of the issue,—presumably an important one.

Several cases involving the right of certain partners to allowances for depletion of their respective interests in oil and gas leases are cited. *Waller v. Commissioner*, 40 Fed. (2d) 892; *Herold v. Commissioner*, 42 Fed. (2d)

942; *Palmer v. Bender*, 287 U. S. 551. The first two cases were decided adversely, and the third favorably, to the taxpayer. It is contended that, as a result of these decisions, several members of the same partnership would in future be taxed upon different bases, if the doctrine of *res judicata* were applied. There is nothing to show that the various litigants are not being taxed upon different bases. The situation, in any event, seems to be unique, for none of the other cases cited on behalf of the Government discloses a similar situation.

The case of *Burnet v. Logan*, 283 U. S. 404, and *Hitchcock v. Commissioner*, 44 Fed. (2d) 756, are merely other instances of possible disparity in taxation if the taxpayer in the second case mentioned had not pursued his legal remedy to its full extent and obtained a reversal of the adverse decision below.

If it be true, however, that an occasional instance of discrimination might result from the application of the doctrine of *res judicata*, can that be sufficient to justify the abolition of the principle in federal income tax litigation? Congress is well aware that the principle of estoppel by judgment is firmly established in the jurisprudence of this country, and if it intended that that principle be not applicable in federal tax litigation it would, doubtless, have expressly so enacted, and not left its intention so concealed in the statute that "nothing but the exigency of a hard case and ingenuity and study of an acute and powerful intellect would discover" it. *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364, 370.

The petitioner complains that the former decision was based on an inadequate or incorrect record, and asserts that otherwise "a contrary result would in all probability have been reached." Even if correct, the complaint

would be insufficient to defeat estoppel. In *United States v. Moser, supra,* it was said (p. 242):

> "But a *fact, question,* or *right* distinctly adjudged in the original action cannot be disputed in a subsequent action, even though the determination was reached upon an erroneous view or by an erroneous application of the law."

To the same effect or *Reed v. Allen,* 286 U. S. 191; *American Express Co. v. Mullens,* 212 U. S. 351.

Despite the inadequacy of the complaint it may, if unanswered, lead to unwarranted inferences, and we, therefore, reply to it.

First, it is said that "it was erroneously stipulated that Company No. 1 'may be taken as identical' with Company No. 2, and the Circuit Court of Appeals accordingly treated the case as though the bonds had been issued by Company No. 2 under its own mortgage." The reason for that stipulation is readily understood when it is remembered that the deduction was disallowed and the case tried on the contention that the regulations, infra, p. 21, allow deductions for discount only to the company which issues the bonds. That being the defense relied upon in the case, it was appropriate to confine the stipulation to such facts as would adequately present the defense. That that issue was adequately presented and comprehensively considered is apparent from the following language of the court:

> "In the second place, we think that, irrespective of the practical identity of the old and new corporations, petitioner is entitled to the deduction claimed because of having taken over the assets and assumed the liabilities of the old corporation which was unquestionably entitled to it. Among the liabilities of the old corporation as shown by its books was the amount set up as bond discount, against which was charged each year an amortized portion thereof. In taking over the liabilities and assets, the new cor-

> poration took the place of the old as to both of these items. As has been said, bond discount is really deferred interest payable at the maturity of the bonds. When, therefore, the new corporation assumed the obligations of the old, its agreement to pay the bonds at maturity embraced necessarily the agreement to pay this deferred interest, which is included in the face of the bonds. As the new corporation is bound to pay this, there is no reason why it should not amortize it in the same way as the old corporation." (33 Fed. (2d) 695, 698).

It seems clear, therefore, that the former decision was not affected by the absence of the details of the 1910 reorganization. The trial court, in disposing of this same contention, pointed out that, although it was not particularly stressed, "the earlier reorganization was before the Board of Tax Appeals and the appellate court in the stipulation of facts and in the pleadings." And, after quoting the above language of the Circuit Court of Appeals in the prior case observed, as we believe, correctly (Record, p. 43):

> "If the foregoing reasoning is to be given proper interpretation, it must be taken as being just as applicable to a plurality, or series of consolidations, as it is to a single one, provided the same essential elements are always successively present, namely, acquisition by the successor corporation of the particular assets and liabilities of its predecessor. If these do exist, then the precise manner of acquisition is not, as the Government contends, material. * * *
>
> "Thus we must conclude that further litigation of the question here raised is precluded by the decision of the Circuit Court of Appeals, because the same material facts were before that court."

The second error, but for which it is averred that the court would "in all probability" have reached a contrary

conclusion, is "that the bond discount in question had not been amortized on the books of either Company No. 1 or Company No. 2, although the Circuit Court of Appeals had assumed the contrary in the earlier decision." The above quotation from the court's opinion leaves little room for the supposition that this assumption had any material bearing upon its conclusion. Nor is it to be taken for granted that the court was not fully aware of the immateriality of how the discount was treated on the books. Mere failure of book entries cannot determine the question of taxability. The Board of Tax Appeals has repeatedly so held, and the Government has, as we understand, adopted the view. Regulations 62, Art. 848; O. D. 111, C. B. 1919, p. 224. *Chicago, Rock Island & Pacific R. R. Co. v. Commissioner,* 13 B. T. A. 998; *Kansas City Sou. Ry. Co. v. Commissioner,* 16 B. T. A. 665. This Court sanctioned the theory in *Doyle v. Mitchell Bros. Co.,* 247 U. S. 179, and in its repeated decisions that substance and not form is to prevail in determining tax liability. *Weiss v. Stearn,* 265 U. S. 242; *United States v. Phellis,* 257 U. S. 156; *Eisner v. Macomber,* 252 U. S. 189.

It would seem, therefore, that there is little to support the averment that "a contrary conclusion would in all probability have been reached" if the details of the 1910 reorganization had been embodied in the stipulation of facts, or if the court had not assumed that the discount had, in fact, been amortized on the books.

The petitioner seeks to distinguish the cases in which this Court has applied the principle to tax litigation, on the ground that the decisions in "all but one" (*Baldwin v. Maryland, supra*) of those cases have allegedly affected only a single taxpayer. An extended and ingenious argument is advanced to support the contention with respect to the decision of this Court in *Deposit*

Bank v. Frankfort, 191 U. S. 499. That case is a striking example of the extent to which this Court has gone in applying the principle, and deserves further reference here.

As the reports of this Court disclose, a great deal of litigation grew out of a Kentucky statute known as the Hewitt act, which provided a certain basis of taxation for banks accepting the provisions of the act. Afterwards, in 1892, a statute was passed creating additional taxes, which the banks contested on the ground that the basis of taxation fixed by the Hewitt act was contractual and could not be impaired by later legislation. This contention was sustained by the court of appeals of Kentucky in the first *Bank Tax Cases,* 31 S. W. 1013, but that decision was overruled in the second *Bank Tax Cases,* 39 S. W. 1030. The Bank of Frankfort had been a party to the first, but apparently not to the second, proceeding. In 1894 suit was entered against it for the recovery of taxes for the years 1893 and 1894, which case went to the court of appeals of the state and that court, following its decision in the second *Bank Tax Cases,* held that the taxes were collectible and remanded the case (57 S. W. 787; 60 S. W. 19). While the latter case was on appeal, and before the opinion was rendered, the authorities undertook to collect the taxes for the years 1895 to 1898. An injunction was granted by the United States Circuit Court for the District of Kentucky, on the ground that the first adjudication in the bank's favor was *res judicata* of the issue. *Bank of Kentucky v. Stone,* 88 Fed. 383. The bank thereupon amended its original pleadings in the state court case, which had in the meantime been remanded, to set up the judgment of the United States Circuit Court as *res judicata.* The court of appeals of Kentucky held that the federal court judgment did not constitute a bar because the state court case upon which it rested had been reversed (65 S. W. 10). From this deci-

sion an appeal was finally prosecuted to this Court, which in *Deposit Bank v. Frankfort, supra,* held that although the decisions of the courts of Kentucky made it clear that the banks of that state were not entitled to exemption from taxation under the act of 1892, nevertheless, in so far as the Deposit Bank of Frankfort was concerned the decision of the United States Circuit Court sustaining its right to exemption from taxation was *res judicata* of the question of its liability for subsequent years.

The instant case is, after all, closely analogous in principle to *Bissel v. Spring Valley Township,* 124 U. S. 225, and not to *Cromwell v. Sac County,* 94 U. S. 351, cited by the petitioner. In *Cromwell v. Sac County,* the first suit on certain bond coupons involved the question of fraud in the sale of the bonds. In the second suit on different coupons of the same bonds, the question was whether the plaintiff was a holder for value. As a different issue was thus raised upon a different demand, there was no estoppel.

But in *Bissel v. Spring Valley Township,* where in the first suit on certain bond coupons it was adjudicated that the bonds were void by reason of forged signatures, and in the second suit, on different coupons of the same bonds, the plaintiff offered evidence not introduced in the prior case to show that the signatures were not forged, this Court held that the previous judgment operated as an estoppel, and said (p. 236):

> "In the former action against the present defendant the adjudication was that the bonds themselves were never signed by the proper officers. * * * Their invalidity equally affected the coupons attached to them, and not merely those in suit, but all others."

In the present case the prior adjudication was that the respondent is entitled to amortize the discount in question for income tax purposes. That decision applied not only to the years then in suit, but to subsequent years as well. The Government should, therefore, be estopped from again contesting the issue, whether under the guise of offering new evidence, or in seeking through this proceeding to obtain a reversal of the former adjudication.

No convincing reason is advanced on behalf of the Government for repudiation of the principle of *res judicata*. Judgments in income tax cases deserve the same sanctity as judgments in other tax cases, or cases in general. If, as contended, the prior judgment of a lower court would become a means of discrimination in favor of a particular taxpayer when there is a later decision to the contrary by this Court, the Government can avoid the situation. If it exercises its full legal remedies in such instances, as it should do where the rights of many tax payers will be affected by the decision, the law thus laid down will be binding upon all. Judgments procured by taxpayers, it must be assumed, are generally correct. And when the Government decides not to appeal from a judgment procured by a taxpayer, it does so in full knowledge of the principle that the rights of the particular taxpayer, as established thereunder, are permanent. As to the instant case, if the prior judgment had been adverse to the respondent, it is hardly to be denied that it would have permanently settled the issue here again involved, adversely to the respondent. The judgment should be given like effect against the Government.

II.

THERE IS NO SUCH DIFFERENCE OF PARTIES AS RENDERS INAPPLICABLE THE PRINCIPLE OF RES JUDICATA.

Identity of parties is conceded by the petitioner as to No. 4174 and No. 4177 (Record, p. 1) of the present consolidated cases, which relate, however, only to the year 1920. The Commissioner of Internal Revenue was the defendant in the former case and the United States of America was the defendant in the above mentioned cases.

The Collector of Internal Revenue is the defendant, however, in No. 4172 and No. 4469, which cover the years 1921 to 1925, inclusive. It is suggested by the petitioner, though apparently not urged, that there may be lack of identity of parties as to these cases, inasmuch as the former proceeding was against the Commissioner of Internal Revenue.

This distinction is nominal only. Since a judgment against a collector, being personal in its nature, is not binding upon the Government, *Smietanka v. Indiana Steel Co.*, 257 U. S. 1; *Sage v. United States*, 250 U. S. 33, *a fortiori* can it not operate by way of estoppel in a subsequent proceeding against the Government. While Congress early enacted that judgments against the collectors may be assumed by the Government in the manner provided, and that no execution shall issue against a collector where there was probable cause for the act done by him, these provisions do not alter the fact that "the suit is personal, and its incidents, such as the nature of the defenses open and the allowance of interest, are different." *Sage v. United States, supra*, p. 37.

But the same considerations do not apply where the prior judgment was against the Government, and the

subsequent proceeding, involving the same issue, is against the collector in his official capacity. For there the defenses would be precisely the same, and there would be but a retrial of the matter formerly adjudicated. The collector in such a situation is defending the suit for the Government and stands in the stead of the Government. There is no reason why, in that situation, the prior adjudication against the United States should not operate as an estoppel in the subsequent proceeding, even though the collector, rather than the United States, may be the nominal party. As stated by the court below (Record, p. 56):

> "Taxes erroneously collected by a collector of internal revenue are received by him in his capacity as an agent of the United States, and if it has been subsequently determined by the judgment of a court that his principal was not entitled to receive them the agent is bound by the judgment and may not contest the point anew. See Second National Bank of Saginaw vs. Woodward, 54 F. (2d) 672; Bertelsen vs. White, 58 F. (2d) 792. The judgment of the District Court is affirmed."

III.

THE APPLICABLE REVENUE ACTS AND REGULATIONS ENTITLE RESPONDENT TO THE DEDUCTIONS, ALTHOUGH ITS PREDECESSOR ISSUED THE BONDS.

There is no contention that bond discount is not a deductible item. The petitioner contends, however, that the right to such deduction is limited by the regulations to the corporation which issued the bonds, and does not, under any circumstance, extend to a successor corporation. Before discussing this contention we briefly outline the facts, which are more fully set forth in the petitioner's brief, and in the record (Record, p. 30, *et seq.*).

Of the total discount of Three Million Six Hundred Thirty-eight Thousand Four Hundred Fifty-one Dollars

and Sixty-seven Cents ($3,638,451.67), the amount of Three Million Twenty-one Thousand Three Hundred Fifty-one Dollars and Sixty-seven Cents ($3,021,351.67) arose from the sale of the bonds in question by Western Maryland Rail Road Company, generally referred to as Company No. 1. The remaining portion of the discount, in the amount of Six Hundred Seventeen Thousand One Hundred Dollars ($617,100.00), arose from the sale of the bonds in question by The Western Maryland Railway Company, generally referred to as Company No. 2. This latter discount is also separately dealt with below.

Western Maryland Rail Road Company was placed in receivership on March 5, 1908, pending a reorganization to accomplish certain readjustments between the two classes of bondholders and the stockholders. A new corporation was created for the purpose and the entire assets of the old company conveyed to it, through the medium of a reorganization committee. The first mortgage bonds in question remained outstanding and were assumed as the primary obligation of the successor (and later by the respondent in the consolidation of 1917). There were second mortgage bonds of the first company in the amount of Ten Million Dollars ($10,000,000.00) which were retired with preferred stock of the second company. The holders of the second mortgage bonds were permitted to purchase a certain amount of the common stock upon specified terms, and the stockholders of the first company were given a share of the new stock for each share of the old held by them, upon payment of forty dollars per share. With this internal readjustment and corporate change, the property was operated as before. (Record, p. 30).

The bonds were sold by the first company over the period from October, 1902 to December, 1908, and One

Million Two Hundred Sixty Thousand Three Hundred Seventy-five Dollars ($1,260,375.00) of the discount in question arose from the sale of a portion of the bonds while the property was actually in the hands of the receiver and the reorganization plans presumably were being worked out. (Exhibit D, pp. 19, 32).

It is the foregoing reorganization which the Government largely relies on as defeating the respondent's right to the deduction. It is the Government's sole contention, in this connection, that the regulations allowing discount as a deduction apply only to the corporation which actually issues the bonds. The applicable provision, which has been reenacted from time to time, in Regulations 45, Sec. 544(3)(a), issued under the 1918 Act, Regulations 62, Sec. 545(3)(a), issued under the 1921 Act, and Regulations 65, Sec. 545(3)(a), issued under the 1924 Act, is as follows:

> "If bonds are issued by a corporation at a discount the net amount of such discount is deductible and should be pro-rated or amortized over the life of the bonds."

The identical provision has appeared in each of the successive regulations to date. It is also provided (Reg. 45, 62, 65, Art. 563):

> "If it (the corporation) sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid. * * *"

These regulations must be regarded as correctly expressing the congressional intent, by reason of the repeated re-enactment without change of the statutory provision allowing deduction of interest, under which the regulations were issued. *Old Colony Railroad Co. v.*

Commissioner, 284 U. S. 552; *Murphy Oil Co. v. Burnet*, No. 80 October Term, 1932.

The controversy between the petitioner and the respondent, if *res judicata* is not to apply, is, therefore, whether the applicable revenue acts and the above quoted regulations limit deductions for the amortization of discount to the corporation which issues the bonds. As the provisions clearly are not expressly so limited, the remaining inquiry is whether reasons exist which require the narrow construction contended for by the Government.

There first arises the natural inquiry why, if the regulations were intended to be thus limited, they did not so state. As they do not so state, the respondent should be entitled to the benefit of the rule repeatedly applied by this Court that in a tax statute the "construction most favorable to the taxpayer" is to be adopted. *Old Colony Railroad Co. v. Commissioner, supra; Miller v. Standard Nut Margarine Co.*, 284 U. S. 498.

Apart from this consideration, it is difficult to discover any sound reason why the regulations should be so restricted. Considering the nature of discount and the position which the respondent occupies with respect to that in question, the principle which justifies amortizing the discount for income tax purposes by the issuing company equally applies to the successor company which takes over the mortgaged property and assumes payment of the bonds and interest.

To be more specific, in the present case the respondent's predecessor, desiring to raise approximately Forty-three Million ($43,000,000.00) Dollars through the sale of its First Mortgage 4% Bonds, found that they could not be

sold at par and that it was necessary to sell Forty-six Million Six Hundred Thirty-three Thousand ($46,633,000.00) Dollars face value thereof to realize the desired amount. It is conceded by the petitioner that, had there been no reorganization, the regulations in question would have authorized the respondent's predecessor to amortize the discount. The basis for the deduction is that discount is, in effect, deferred interest. Now that the property has been taken over by the respondent and the payment assumed by it of the bonds and interest, does not the underlying reason for allowing the deduction to the issuing company require that it be allowed to the respondent? It is clear that the respondent stands in precisely the same situation that its predecessor did with respect to the property acquired by the proceeds from the sale of the bonds, which is mortgaged to secure the bonds, and to the obligation created by the bonds, and that when the respondent ultimately pays the discount it will emerge in exactly the same financial situation, as a result of the transaction, as would its predecessor if there had been no reorganization. The reason for allowing the deduction is not the mere issuing of the bonds at a discount, but the fact that the cost of the borrowed money, which the discount represents in part, must ultimately be paid. The respondent having taken over the property and assumed payment of the bonds, the debt has become its own. The respondent is currently paying the cost of the money which the stipulated interest represents, and it will pay the cost which the discount represents when it pays the bonds at par. There is exactly the same reason, therefore, why the respondent should take the deduction as if it had actually issued the bonds in the first instance,

instead of assuming them later. As the discount may not be deducted wholly in the year when it is paid, the regulations should be construed to permit the deductions in question.

Stated in another way, there is in effect one business upon which the bonds and the discount constitute an obligation, although it has been conducted successively by more than one corporation. The Court should, in our view, look to the substance of the matter and allow the deduction for the cost or loss to the business which sustains it. *Industrial Cotton Mills v. Commissioner,* 61 Fed. (2d) 291.

The Government's contention that the right does not extend to a successor company would perhaps be tenable if the transaction had been accomplished in such manner as to relieve the respondent of any obligation with respect to the bonds, but it should have no application to the situation which actually exists.

IV.

THE RESPONDENT IS, IN ANY EVENT, ENTITLED TO DEDUCT FOR THE DISCOUNT IN THE SALE OF THE BONDS AFTER THE 1910 REORGANIZATION.

If the foregoing contention on behalf of the respondent is correct, it is unnecessary to consider the 1917 consolidation. If, however, this Court should hold that the principle of *res judicata* is not applicable, and that the 1910 reorganization cut off the right to the deduction, there arises the further question whether the respondent is not, in any event, entitled to deduct for the discount in the amount of Six Hundred Seventeen Thousand One Hundred Dollars ($617,100.00) suffered in the sale of a portion of the bonds by The Western Maryland Railway Company (Company No. 2) after the 1910 reorganiza-

tion. That question would turn upon the effect of the consolidation of 1917. The decision in the prior case was admittedly an adjudication of that question and should settle the respondent's right to deduct the discount suffered by the second company. That conclusion should follow not only because of the prior adjudication but because of the nature and effect of the consolidation, the facts pertaining to which are set forth in the record (pp. 32-34). The more essential facts are briefly:

The Western Maryland Railway Company, also a Maryland corporation, owned the entire capital stock of certain subsidiary corporations, which had been formed from time to time as a convenient method of financing the construction of certain extensions of the railroad, and operated such extensions in its own name and as an integral part of its system. In 1917 the principal company and its subsidiaries were consolidated under the laws of the states of Maryland and Pennsylvania (some of the subsidiary companies being corporations of the latter state), thereby forming Western Maryland Railway Company, the respondent.

Under Article V of the Agreement of Consolidation (Exhibit A), the consolidated company expressly assumes all obligations, agreements and stipulations set forth in the Mortgage of October 1, 1902, securing the bonds, the discount from the sale of which is in question in this case. The provision is, in part:

> "and the said consolidated corporation shall possess and may exercise each and every right and power reserved to and heretofore possessed by the constituent companies, or any of them, in respect of any such mortgage * * * including each and every right and power reserved to and heretofore possessed by Western Maryland Rail Road Company or by The

> Western Maryland Railway Company under the terms of" said mortgage * * * "including the right and power to require the certification * * * of the bonds by the Trustee, * * * and the right and power to issue and use the said bonds for the purposes and objects for which the same are reserved * * * and any such bonds and other obligations may be so issued in the name of Western Maryland Rail Road Company or in the name of the consolidated corporation as may be deemed desirable by the Board of Directors of the consolidated corporation."

Article 23, sections 33 and 34, of the Annotated Code of Maryland (1924), provides with respect to consolidation of corporations that—

> "all of the property and assets belonging to said consolidating corporations of whatsoever nature and description, and all the powers and rights and all debts and liabilities of said consolidating corporations of whatsoever nature and description, shall be devolved upon said new corporation, which shall be regarded as *substituted by operation of law in the room and stead of said consolidating corporations.*" (Italics supplied.)

In *State, Use of Dodson v. Baltimore, etc. R. R. Co.*, 77 Md. 489, 491-2, the Court of Appeals of Maryland held regarding the effect of such a consolidation that—

> "The new corporation thus created was in reality the embodiment under another name of the two formerly existing. They had been joined together in every faculty and function, and molded into an indivisible unit, with none of their rights impaired and none of their responsibilities abated. If this were not the result of the consolidation, very great inconvenience and injustice would arise. The Act of Assembly enables two corporations to consolidate upon such terms as may be agreed upon."

Article I of the Agreement of Consolidation, in the broadest and plainest terms, vests in the consolidated company all the "powers, rights, privileges, immunities, franchises and property of every name, nature and description * * * of each of the constituent companies * * *."

Indeed, The Western Maryland Railway Company and its subsidiaries may be regarded as merged prior to the consolidation, for all practical purposes, on the authority of *Southern Pacific Co. v. Lowe,* 247 U. S. 330, where the Southern Pacific Company owned the entire capital stock of the Central Pacific Company and was in actual physical possession of the latter's railways and other assets, and in charge of its operations under a lease. Dividends were declared by the Central Pacific. In discussing the relationship of the two companies, and as reflecting upon whether the dividends received by the proprietary company were taxable income, this Court relied

> "upon the fact that the Central Pacific and the Southern Pacific were in substance identical because of the complete ownership and control which the latter possessed over the former, as stockholder and in other capacities. *While the two companies were separate legal entities, yet in fact, and for all practical purposes, they were merged, the former being but a part of the latter, acting merely as its agent, and subject in all things to its proper direction and control.*" (Italics ours.)

This Court has, indeed, expressed the view that the identity of the constituent corporations is not lost by consolidation. *Nashua & Lowell R. R. Corp. v. Boston & Lowell R. R. Corp.,* 136 U. S. 363; *Philadelphia, Wilmington & Baltimore R. R. Co. v. Maryland,* 10 How.

376, 393; *Minot v. Philadelphia, Wilmington & Baltimore R. R. Co.* (The Delaware Railroad tax), 18 Wall. 206, 228.

While it is true that under the Maryland law a new corporate entity arises in a consolidation of corporations, it is equally clear that under the law of that state the change is a purely formal one. The new entity is "substituted by operation of law in the room and stead of said consolidating corporations." The substituted corporation is, to all intents and purposes, regarded as the equivalent of its predecessor. That is peculiarly true in the instant case, because the act done by The Western Maryland Railway Company was merely to embody with itself in one corporate structure its several wholly owned subsidiary companies. If, therefore, substance and not form is to determine tax liability, there is no escape from the conclusion that the respondent is as much entitled to deduct the discount in question as was the company which was its predecessor in form only.

Respectfully submitted,

EUGENE S. WILLIAMS,
WILLIAM C. PURNELL,
Attorneys for Respondent.

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